IN THE SUPREME COURT OF THE STATE OF MONTANA

No. DA 16-0739

ALPS PROPERTY & CASUALTY INSURANCE COMPANY, d/b/a Attorneys Liability Protection Society, a Risk Retention Group,

Plaintiff and Appellees,

v.

McLEAN & McLEAN, PLLP; DAVID McLEAN; MICHAEL McLEAN; and MIANTAE McCONNELL,

Defendants and Appellants.

McLEAN & McLEAN, PLLP and MICHAEL McLEAN,

Counter Plaintiffs and Appellants,

v.

ALPS PROPERTY & CASUALTY INSURANCE COMPANY,

Counter Defendants and Appellees.

JOSEPH MICHELETTI and MARILYN C. MICHELETTI,

Intervenors and Appellants.

On Appeal from the Montana Third Judicial District Court,
Deer Lodge County, Cause No. DV-14-82
Hon. James A. Haynes

Joint Opening Brief of McLean & McLean, PLLP, and Michael McLean

---

Appearances:

Timothy B. Strauch
Strauch Law Firm, PLLC
257 West Front Street, Suite A
Missoula, MT 59802
T: (406) 532-2600/F: (406) 542-3332
tstrauch@strauchlawfirm.com

Attorney for McLean & McLean, PLLP

Patrick T. Gallagher
Wall, McLean & Gallagher, PLLC
P.O. Box 1413
Anaconda, MT 59711
T: (406)563-8409/F: (406) 563-8400
pat@mlfpllc.com

Attorney for Michael McLean

Stefan Wall
Wall, McLean & Gallagher, PLLC
P.O. Box 1713
Helena, MT 59624
T: (406)442-1054/F: (406)442-6455
stefan@mlfpllc.com

Attorney for David McLean

Doug Scotti
Sharon M. Morrison
Morrison & Frampton, PLLP
Frank Lloyd Wright Building
341 Central Avenue
Whitefish, MT 5993 7
T: (406)862-9600/F: (406) 862-9611
doug@morrisonframpton.com
smmmontana@gmail.com

Attorneys for Miantae McConnell

Martha Sheehy
Sheehy Law Firm
P.O. Box 584
Billings, MT 59103
T: (406)252-2004/F: (866) 477-5953
msheehy@sheehylawfirm.com

Attorney for ALPS Property &
Casualty Insurance Company

Bradley J. Luck
Garlington, Lohn & Robinson, PLLP
P.O. Box 7909
Missoula, MT 59807-7909
T: (406) 523-2500/F: (406) 523-2595
bjluck@garlington.com

Attorney for ALPS Property &
Casualty Insurance Company

Janice M. Casarotto
Casarotto Law Firm, PLLC
P.O. Box 3723
Butte, MT 59702
T: (406) 565-2726
casarottolawfirm@gmail.com

Attorneys for Lillian Johnson

William M. O'Leary
Fleming & O'Leary, PLLP
P.O. Box 527
Butte, MT 59703
T: (406) 723-5600/F: (406) 723-5602
wmo@flemingandolearlylaw.com

Attorneys for Joseph F. and
Marilyn C. Micheletti

Table of Contents

Page No.

Page No.

Note: separate Appendix filed

Table of Authorities

Page No.

Cases

Page No.

Page No.

Page No.

Page No.

Laws and Rules

1. Issue Presented

Did the court err in rescinding the legal malpractice insurance policy and declaring it void *ab initio* as to innocent insureds and innocent victims due to David McLean's failure to disclose his thefts?

2. The Case

McLean & McLean, PLLP, Michael McLean, and David McLean each consistently were continuously insured under ALPS "claims-made" policies from 2003 to 2014. In 2014, they notified ALPS they had reported David to the ODC for secretly stealing client money. ALPS subsequently received multiple claims against David and M&M. Some related to the thefts. Others were for alleged acts of malpractice wholly unrelated to the thefts. M&M's and Michael's appeal is only about coverage for the claims for the non-theft-related acts of malpractice. The Lawyer's Fund for Client Protection handled the theft claims.

David is disbarred and currently in federal prison serving a 44-month sentence. In this case, he consented to judgment against him. That, too, is not an issue on appeal.

ALPS first sent reservation-of-rights letters. Next it attempted to cancel the policy for non-payment of the premium, which somehow resulted in a refund of a

surplus premium. ALPS then attempted to rescind the policy due to alleged misrepresentations contained in the renewal applications relating to David's thefts. M&M and Michael disputed the rescission as to them and requested "Innocent-Insured" Coverage.

Shortly thereafter, ALPS sued its insureds and some of the malpractice claimants for rescission, declaratory relief, and reimbursement. Except for David, the defendants filed counterclaims for declaratory and monetary relief. The court granted ALPS summary judgment, rescinded the policy, and declared it void *ab initio* based upon what it considered were material misrepresentations made in the renewal applications relating to David's thefts. It dismissed all counter-claims and third-party claims against ALPS.

M&M and Michael, and two of the malpractice claimants, McConnell and Micheletti, now appeal that judgment.

3. The Facts

A. The Renewal Application and ALPS Policy.

In 2003, David McLean and his son, Michael McLean, began practicing law at the law firm of McLean and McLean, PLLP ("M&M") in Anaconda, Montana. From 2003 until July 2014, David was M&M's managing partner. *Doc. 1,* ¶¶*10-*

11; Doc. 4, ¶II; Doc. 12, ¶5; Doc. 29, ¶II.[1] From inception, M&M maintained professional liability insurance with ALPS.

In 2013, ALPS the individual renewal applications by M&M, David, and Michael. *Doc. 35, ¶¶1 and 9 & Ex. 7, Appendix (App.),* ***Tab 10****.* In the application questionnaire to the firm, M&M answered "No" to the question: "Are you or any member of the firm aware of or do you or any member of your firm have knowledge of any fact, circumstance, act, error, or omission that could reasonably be expected to be the basis of a claim against any current or former attorney in the firm or its predecessors, regardless of the merit of such claim that has not already been reported to ALPS?" *Id.* In the individual questionnaires to them, David and Michael each answered "No" to the question: "Are you aware of or do you have knowledge of any fact, circumstance, act, error, or omission that could reasonably be expected to be the basis of a claim against you, regardless of the merit of such claim?" *Id.* They also gave similar answers to similar questions on prior annual renewal applications. *Doc. 35, ¶¶1-8 & Exs. 1-6.*

After acceptance of the application, ALPS issued ALPS7804-11 for the policy period January 1, 2014 to January 1, 2015 (the "Policy"). *Doc. 35, ¶¶1 and 10 & Ex. 8, App.,* ***Tab 9****.* Under the Policy, M&M was the "Named Insured" while

[1] Refers to Doc. Seq. numbers in the District Court Case Register Report.

David and Michael were each identified as an "Insured Attorney." *App., Tab 9, p.1 (of 22).*

The Policy states, in relevant part:

> Subject to the **Limit of Liability**, exclusions, conditions and other terms of **this Policy**, the **Company** agrees to pay on behalf of the **Insured** all sums (in excess of the **Deductible** amount) that the **Insured** becomes legally obligated to pay as **Damages**, arising from or in connection with A **CLAIM** FIRST MADE AGAINST THE **INSURED** AND FIRST REPORTED TO THE **COMPANY** DURING THE **POLICY PERIOD**, provided that:
>
> 1.1.1 the **Claim** arises from an act, error, omission or **Personal Injury** that happened on or after the **Loss Inclusion Date** and the **Retroactive Coverage Date** set forth in Items 2 and 3 of the Declarations, and that the **Claim** arises from or is in connection with:
>
> > (a) an act, error or omission in **Professional Services** that were or should have been rendered by the **Insured**, or
> >
> > (b) a **Personal Injury** arising out of the **Professional Services of the Insured**;
>
> 1.1.2 at the **Effective Date** of this **Policy**, no **Insured** knew or reasonably should have known or foreseen that the act, error, omission or **Personal Injury** might be the basis of a **Claim**[.] [Emphasis in original]

Id., p. 9 (of 22), § 1.1.

"**Claim**" is defined as "a demand for money or services, including but not limited to the service of suit or institution of arbitration proceedings against the Insured." *Id., p. 11 (of 22), § 2.3.* "**Damages**" is defined as "any monetary award by way of judgment or final arbitration, or any settlement." The Policy

specifically excludes from the definition of Damages "injunctive, declaratory, or other equitable relief, or costs or fees incident thereto" and "restitution, reduction, disgorgement or set-off of any fees, costs, consideration or expenses paid to or charged by an Insured, or any other funds or property of any person or entity presently or formerly held in any manner directly or indirectly controlled by an Insured." *Id., p. 12 (of 22), § 2.6.* "**Professional Services**" is defined by the Policy, in part, as "services or activities performed for others as an Attorney in an attorney client relationship on behalf of one or more clients applying the Attorney's specialized education, knowledge, skill, labor, experience and/or training." *Id., p. 14 (of 22), § 2.24.* "**Related Professional Services**" means "**Professional Services** that are connected temporally, logically or causally, by any common fact, circumstance, situation, transaction, event, advice or decision, including but not limited to work that is part of the same or continuing **Professional Services**." *Id., § 2.25.*

The Policy contains several provisions excluding coverage for David's thefts. *Id., pp. 15-16 (of 22), §§ 3.1.1, 3.1.3, 3.1.8, and 3.1.9.*

The Policy states:

> By acceptance of this Policy, each Insured agrees with, represents to and assures the Company that the statements, information and representations in the Declarations, in the application for this Policy, and in the applications for

> each prior policy issued by the Company to the Insured, are true and correct, that the Declarations and the application form a part of this Policy, and that this Policy is issued in reliance upon the truth of such statements, information and representations.

Id., p. 21 (of 22), § 4.14.1. The Policy also stated: "[a]ll current and previously submitted application forms delivered to [ALPS] are made a part of the policy." *Id., p. 1 (of 22).* Neither of those clauses provides a remedy in the event of a misrepresentation.

The Policy provides the following "Innocent-Insured Coverage":

> [w]henever a Claim otherwise covered by this Policy would be excluded based on Section 3.1.1,[2] coverage will be afforded to any individual Insured who did not personally commit, or personally participate in committing, any such act, error or omission ..., and who did not remain passive after learning of the act, error, [or] omission..., provided that each such individual Insured shall have immediately notified the Company and complied with all obligations under this Policy once said Insured obtained knowledge of the act, error, [or] omission[.] Nothing in this section shall be interpreted to afford any coverage to a Named Insured that is an entity rather than an individual.

Id., pp. 17-18 (of 22), § 4.3.1.

The Policy provides for an Extended Reporting Period Endorsement ("ERE") in the event of the expiration or cancellation (on specified conditions) of the Policy exercisable upon written request and upon payment of the additional

[2] 3.1.1 says: "Any dishonest, fraudulent, criminal, malicious, or intentionally wrongful or harmful act, error or omission committed by, at the direction of, or with the consent of an Insured, or any Personal Injury arising from such conduct, subject to Section 4.3 of this Policy ('innocent insured coverage')."

premium specified not more than thirty days after termination of the Policy. The ERE extends the reporting period during which a Claim may first be reported to ALPS under the Policy. *Id., pp. 18-19 (of 22), § 4.4.*

ALPS could not cancel the Policy before the expiration date except under the following relevant circumstances:

> 4.13.2.1 for reasons specifically allowed by statute;
>
> 4.13.2.2 for failure to pay a premium when due;
>
> 4.13.2.3 upon a material misrepresentation by the Insured;
>
> 4.13.2.4 upon a substantial change in the risk assumed by the Company, except to the extent that the Company should reasonably have foreseen the change or contemplated the risk as of the Effective Date of the policy;
>
> 4.13.2.5 upon a substantial breach of contractual duties, conditions, or warranties by the Insured, including failure by the Insured to repay a deductible or any other money owed to the Company upon demand;...

Id., p. 6 (of 22), § 4.13.2. Under those provisions, ALPS could not cancel coverage retroactively. It could only cancel prospectively on 10-day notice. *Id., § 4.13.3.* There is no provision in the Policy for rescission or retroactive cancellation for any reason.

Finally, "[a]ny and all provisions of this policy that are in conflict with applicable laws of the State of Montana are hereby amended to conform to the

minimum requirements of Montana law...." *Id., p. 7 (of 22), § 4.20.*

B. David's Illegal Acts.

On July 22, 2014, a secretary at M&M discovered irregularities in David's handling of client funds and management of M&M's IOLTA trust account, and alerted Michael to these issues. Michael immediately reviewed client files and confronted David. David admitted that, beginning approximately in 2010, he misappropriated client funds and funds of the Montana Chapter of the American Board of Trial Advocates for which he served as treasurer ("David's Illegal Acts") *Doc. 1, ¶¶12-13; Doc. 4, ¶II; Doc. 12, ¶5; Doc. 29, ¶II.*

M&M and Michael were previously unaware of David's Illegal Acts. Those acts were unauthorized and outside the scope of David's employment and agency with M&M. *Doc. 42, App.* ***Tab 5****, ¶¶2-4; Doc. 45, Ex. A, App.* ***Tab 4****, ¶¶6-7.*

On July 23, Michael and David separately reported the matter to the Office of Disciplinary Counsel for the State of Montana, which opened an investigation. *App. Tab 4, ¶12 & Ex. 7.*

On August 4-5, David's counsel, Michael McMahon, notified clients affected by Davis's Illegal Acts. David ceased practicing law and Michael began winding down and closing M&M. *Doc. 36, Ex. 1, 2.*

On August 28, David filed a verified petition with this Court, requesting that

it disbar him. On March 17, 2015, following proceedings before the Commission on Practice, this Court disbarred David. The Commission had recommended David should be ordered to reimburse all former clients for all funds misappropriated by him and to reimburse the Montana Lawyers' Fund for Client Protection ("FCP") in all amounts that it pays to former clients as a result of his misconduct and misappropriation of client funds. This Court ordered David to reimburse each specified theft. *Doc. 34, Ex. A.*

In August 2015, David pled guilty to federal criminal charges and admitted "he knowingly devised a scheme or plan to defraud, or a scheme or plan for obtaining money or property by means of false or fraudulent pretenses, representations, or promises." *Doc. 34, Ex. C, p. 3.* On September 25, 2015, the United States District Court, Montana, adjudged David guilty of two counts of wire fraud in violation of 18 U.S.C. § 1343 and one count of identity theft in violation of 18 U.S.C. § 1028(a)(l). *Id., Ex. D.*

C. Notice to ALPS of David's Illegal Acts and Malpractice Claims.

On July 24, 2014, two days after discovering David's Illegal Acts, M&M and Michael reported the matter to ALPS. *Doc. 1, ¶36; Doc. 4, ¶II; Doc. 12, ¶13; Doc. 29, ¶II.* On July 29, ALPS sent a Reservation of Rights letter regarding supplementary payments coverage under the Policy based on the notice of the

reports made to the ODC. *Doc. 36, Ex. 1, 2.*

On August 15, client McConnell advised ALPS of her malpractice claim against David (ALPS Claim No. B149241). On August 21, client Johnson provided notice of their legal malpractice claim against David (ALPS Claim No. B149273). On September 24, following ALPS' receipt of additional information from David and Michael, including information about David's Illegal Acts, the Johnson Claim, and the McConnell Claim, ALPS sent supplemental Reservation of Rights letters regarding ALPS' provision of supplementary payments coverage for the ODC investigation and ALPS' acceptance of the defense of the Johnson Claim and the McConnell Claim. *Id.*

On October 16, client Micheletti requested that M&M place ALPS on notice of their claims against David, which it did. *Doc. 51, ¶11; Doc. 52, ¶11.*

D. ALPS First Cancels and Then Rescinds the Policy.

On August 20, 2014, ALPS sent M&M a *Notice of Cancellation* of the Policy, effective September 4, 2014. The reason given was: "Non-payment of premium: $1,422.10." *Doc. 35, ¶15 & Ex. 10, App.* ***Tab 8.***

On September 5, ALPS sent M&M a second *Cancellation* also effective September 4. It stated:

In consideration of an unearned premium of $3,105.00, state tax of $0.00

> and state fee of $0.00 this policy is hereby cancelled as of 9/4/2014. This is a Pro Rate [sic] Cancellation.
>
> **Unearned Premium:** $3,104
> **Finance Payoff:** $2,873.59
> **Amount due to Insured:** $231.41

*Doc. 45, ¶8 & Ex. 4, App., **Tab 7** (emphasis in original).* On or around September 9, ALPS sent M&M a check in the amount of $231.41. *Id.*

By letter dated September 11, Michael requested Innocent-Insured Coverage for him and an ERE for him and M&M. *App., Tab 4, Ex. 9.* ALPS did not respond to that request before Michael sent a second letter to ALPS dated September 24, in which he: (1) asserted the notice of cancellation was defective; (2) returned the $231.41 check; and (3) requested ALPS to apply the $231.41 toward the premium for the ERE. *Id., Ex. 10.* ALPS never provided Innocent-Insured Coverage or a quote for the ERE.

On September 26, ALPS sent a *Notice of Rescission of Coverage*. *Doc. 35, ¶14 & Ex. 9, App. **Tab 6**.* The notice purported to rescind coverage retroactively to the original Policy effective date, January 1, 2014, and stated in pertinent part:

> You are hereby notified in accordance with the terms and conditions of the above mentioned Claims Made Lawyers Professional Liability policy, and in accordance with the law, that the above mentioned policy is rescinded as of the inception date with no coverage being afforded.
>
> ***

> Reason(s) for rescission of coverage of insurance:
>
> Misrepresentation, omission, concealment of facts, and incorrect statements by the Named Insured in the application for insurance which were fraudulent and material to the acceptance of the risk and the hazard assumed by the Company. The Company in good faith would not have issued the policy if the true facts had been made known to the Company as required by the application for insurance or otherwise.

Id. ALPS also sent M&M a check for $6,657.59 as the return of premium. *Id.* M&M returned the tender of the refund. *Doc. 12, ¶14; Doc. 17, ¶14.*

E. ALPS Sues its Insureds and Some Claimants.

On October 8, 2014, ALPS filed its complaint against defendants containing the following counts: (1) rescission, (2) declaratory relief (in the alternative to rescission), and (3) reimbursement. *Doc. 1.*

David answered the complaint, requesting the court to enter judgment in favor of ALPS against him but not against M&M, Michael, Lillian Johnson, or McConnell. *Doc. 4.* McConnell answered and counterclaimed, requested a declaration that the Policy is in full force and effect and provides her with coverage for David's and M&M's acts and omissions. *Doc. 10.* M&M answered and counterclaimed, requesting: (1) declaratory judgment that the Policy remains in full force and effect including the right to an Extended Reporting Period Endorsement, ALPS unlawfully cancelled the Policy, ALPS unlawfully rescinded the Policy, and

ALPS is not entitled to reimbursement from anyone (Count I); and (2) compensatory damages for breach of contract (Count 2). *Doc. 12.* Michael answered and counterclaimed, requesting: (1) declaratory judgment that ALPS has obligations to Michael under the Policy, ALPS unlawfully cancelled Michael's insurance coverage, ALPS unlawfully rescinded Michael's insurance coverage, ALPS has a duty to defend Michael for any and all claims made, and ALPS is not entitled to reimbursement from Michael for defense costs; (2) breach of contract, including for failing or refusing to recognize Michael as an "innocent insured" under the Policy and for failing or refusing to issue an ERE; (3) breach of the implied covenant of good faith and fair dealing, (4) tortious breach of the implied covenant, (5) violation of the Montana Unfair Claim Practices Act, and (6) intentional and negligent infliction of emotional distress. *Doc. 29.* Micheletti answered and counterclaimed, requesting declaratory judgment that the Policy provides coverage for their claims asserted in the Third Judicial District case styled *Micheletti v. McLean,* DV-2015-67. *Doc. 41.*

On July 31, 2015, the court dismissed without prejudice defendant Johnson, who stipulated to be bound by the court's judgment. *Docs. 23-24.*

ALPS moved for summary judgment. *Doc. 33.* David responded and M&M joined in that response. *Docs. 42-43.* Michael separately responded and filed a

cross-motion. *Docs. 44-45.*

On June 20, 2016, the court issued its *Opinion and Order*, granting in part ALPS' motion and declaring the Policy rescinded and void *ab initio* as to M&M, Michael, and David, based on misrepresentations in the renewal application. The court reserved judgment to the extent its order would bind McConnell and Micheletti. *Doc. 47, App., **Tab 3**.*

On September 19, the Court issued a second *Opinion and Order*, granting ALPS' motion and declaring the Policy rescinded and void *ab initio* as to all parties. *Doc. 62, App., **Tab 2**.* On November 14, 2016, the court entered *Judgment* in favor of ALPS and dismissing all counter-claims and third-party claims against ALPS. *Doc. 67, App., **Tab 1**.*

4. Standard of Review

This Court reviews *de novo* a district court's rulings on summary judgment, applying the same criteria of M. R. Civ. P. 56 as a district court. *Pilgeram v. GreenPoint Mortg. Funding, Inc.,* 2013 MT 354, ¶9, 373 Mont. 1, 313 P.3d 839 (citation omitted). The Court reviews a district court's conclusions of law to determine whether they are correct and its findings of fact to determine whether they are clearly erroneous. *Id.*

"[T]he interpretation of an insurance contract is a question of law." *Meadow Brook, LLP v. First Am. Title Ins. Co.,* 2014 MT 190, ¶14, 375 Mont. 509, 329 P.3d 608. The questions of materiality and good faith under § 33-15-403, MCA are questions of fact. *Schneider v. Minnesota Mut. Life Ins. Co.,* 247 Mont. 334, 340, 806 P.2d 1032, 1036 (1991); *Williams v. Union Fid. Life Ins. Co.,* 2005 MT 273, ¶32, 329 Mont. 158, 123 P.3d 213.

The Court applies general rules of contract law and construes insurance policies "against the insurer and in favor of the insured." *Parker v. Safeco Ins. Co. of America,* 2016 MT 173, ¶14, 384 Mont. 125, 376 P.3d 114. "A court should interpret terms in an insurance policy according to their usual, common-sense meaning as viewed from the perspective of a reasonable consumer of insurance products." *Id.* "Ambiguity exists when the insuring document, taken as a whole, is reasonably subject to differing interpretations, and ambiguity should be construed in favor of the insured." *Id.*

Further, the reasonable expectations doctrine applies even if the policy language is unambiguous. *Meadow Brook,* ¶16. Under that doctrine, "The objectively reasonable expectations of applicants and intended beneficiaries regarding the terms of insurance contracts will be honored even though painstaking study of the policy provisions would have negated those expectations." *Id.*, ¶15,

quoting*: Fisher v. State Farm Mut. Auto. Ins. Co.,* 2013 MT 208, ¶20, 371 Mont. 147, 305 P.3d 86 (quoting: *Transamerica Ins. Co. v. Royle,* 202 Mont. 173, 180-81, 656 P.2d 820, 824 (1983)). The genesis of this doctrine is "the judicial recognition that most insurance contracts, rather than being the result of anything resembling equal bargaining between the parties, are truly contracts of adhesion in which many insureds face two options: (1) accept the standard insurance policy offered by the insurer, or (2) go without insurance." *Id.,* quoting: *Giacomelli v. Scottsdale Ins. Co.,* 2009 MT 418, ¶42, 354 Mont. 15, 221 P.3d 666. "The doctrine is consistent with Montana's strong public policy that insurance is to serve a fundamental protective purpose; moreover, it 'goes hand in hand with our rule of strictly construing policy exclusions.'" *American Family Mut. Ins. Co. v. Livengood,* 1998 MT 329, ¶32, 292 Mont. 244, 970 P.2d 1054, quoting: *Wellcome v. Home Ins. Co.*, 257 Mont. 354, 358, 849 P.2d 190, 193 (1993).

Under the reasonable expectations doctrine, "'the objectively reasonable expectations of insurance purchasers regarding the terms of their policies should be honored.'" *Stonehocker v. Gulf Ins. Co.,* 2016 MT 78, ¶15, 383 Mont. 140, 368 P.3d 1187, quoting: *Am. States Ins. Co. v. Flathead Janitorial & Rug Servs.,* 2015 MT 239, ¶22, 380 Mont. 308, 355 P.3d 735.

5. Summary of Argument

Michael did not commit any of David's bad acts, did not know about them, and aggressively took action and reported them when he learned of them. That is all ALPS required of Michael to receive Innocent-Insured Coverage under the express terms of the Policy. It was reasonable for him to expect he and his clients would be given that protection – if not from ALPS, at least by the court. The Policy did not give ALPS the right to rescind or void the Policy. ALPS had to obtain court relief. That meant the common-law doctrines of reasonable expectations, the prudent insurer, and the innocent insured all applied. Each exists to further Montana's strong public policy in favor of insurance protection. The court below failed to apply those doctrines for the innocent people here.

6. Argument

A. Michael reasonably expected and should be given Innocent-Insured Coverage under the Policy.

The court held it would be unreasonable for Michael to consider himself "innocent" because the Policy indicates ALPS' "clear intent to rely upon the representations that the statements in the applications are true." *App., Tab 3, p.*

31.[3]

Michael contends he reasonably expected the Policy would cover him as an Innocent-Insured under Section 4.3.1. *App., Tab 9, pp. 17-18 (of 22).* It is undisputed that: a) Michael "did not personally commit, or personally participate in committing, any such act, error or omission"; b) "did not remain passive after learning of the act, error, [or] omission" – but rather promptly took action to notify the authorities and clients; and c) immediately notified ALPS and complied with all obligations under the Policy once he obtained knowledge of those Acts. Based on the plain language of the Policy, his was an objectively reasonable expectation.

The court relied upon other Policy provisions as being contrary to that expectation, including: a) the language in the Individual Attorney Supplement ("I understand information submitted herein becomes a part of my firm's Professional Liability Application and is subject to the same terms and conditions"); b) Section 4.14 of the Policy, which states that each insured represents that the representations in the application for the Policy are true and correct and that the Policy was issued in reliance upon such information; and c) Section 4.15, which incorporates the application by reference into the Policy. *App., Tab 9, pp. 31-32.* Those

[3] M&M acknowledges it is not entitled to Innocent-Insured Coverage under the Policy, which excludes such coverage for the named-insured entity. M&M does seek protection under the common-law innocent-insured doctrine, discussed in the next section of this brief.

provisions, however, do not address, let alone override, the provision for Innocent-Insured Coverage under Section 4.3.1.

Section 4.3.1 does not void Innocent-Insured Coverage if another insured makes a misrepresentation that the Innocent-Insured does not know of. Nor is it reasonable to expect that it would. Under the plain language of the Policy, Michael can be "innocent" of his father's "dishonest, fraudulent, criminal, malicious, or intentionally wrongful or harmful conduct," and still be covered. It makes no sense that he cannot equally be "innocent" of his father's failures to disclose such conduct in the application. Otherwise, Innocent-Insured Coverage would be illusory. It would never be available to any insured so long as the guilty insured failed to disclose his conduct. So, because David was dishonest, Michael cannot obtain Innocent-Insured Coverage – even though Section 4.3.1 says Michael can, so long as Michael himself was not dishonest and not passive and reported it when he learned. Michael met those requirements. Under what set of circumstances would Michael ever have been entitled to Innocent-Insured Coverage, so long as his father was dishonest?

The court below failed to recognize that Section 4.3.1 distinguishes between actual knowledge and imputed knowledge. Imputed knowledge is why the firm could not qualify. However, Section 4.3.1 does not impute knowledge to Michael.

"The innocent insured provision shows that the parties intended to distinguish actual from imputed knowledge and not to penalize insureds who did not have actual knowledge of wrongful acts." *Great American Ins. Co. v. Christy,* 164 N.H. 196, 203, 53 A.3d 538, 544 (2012), citing: *Maher & Williams v. ACE American Ins. Co.,* No. 3:08cv1191, 2010 WL 3546234, at *13 (D.Conn. Sept. 3, 2010); and *Holloway v. Sacks and Sacks, Esqs.,* 275 A.D.2d 625, 713 N.Y.S.2d 162, 164 (2000).

Under the reasonable expectations doctrine, the Policy provisions incorporating the applications "cannot create an exclusion from coverage where the terms of the insurance policy do not clearly demonstrate an intention to exclude such coverage." See *Winter v. State Farm Mut. Auto. Ins. Co.,* 2014 MT 168, ¶19, 375 Mont. 351, 328 P.3d 665. Further, a provision in an insurance policy "that defeats coverage for which valuable consideration has been received violates Montana public policy." *Estate of Gleason v. Central United Life Ins. Co.,* 2015 MT 140, ¶24, 379 Mont. 219, 350 P.3d 349.

Contrary to the district court's conclusion, any ambiguity between the provisions in the Policy incorporating the applications and the provisions for Innocent-Insured Coverage must be construed against ALPS "and in favor of extending coverage." *Modroo v. Nationwide Mut. Fire Ins. Co.,* 2008 MT 275,

¶23, 345 Mont. 262, 191 P.3d 389. This Court should do so to further the object of the insurance contract, which is to give protection, *Giacomelli, supra*, and because insurers draft the language of insurance contracts, see *Pablo v. Moore,* 2000 MT 48, ¶22, 298 Mont. 393, 995 P.2d 460.

For these reasons, Michael asks this Court to reverse the judgment voiding the Policy as to him, and to determine as a matter of law that he is entitled to Innocent-Insured Coverage under Section 4.3.1. The case should be remanded for reinstatement of the Policy to Michael, determination of the premium, and trial of the counterclaims and third-party claims relating to that coverage.

B. M&M and Michael are innocent insureds under the common-law doctrine.

The court held "the common law innocent insured doctrine does not apply to prevent rescission of the Policy...." *App., Tab 3, p. 35.*

There is a split of authority in terms of whether the court was correct. Montana has not yet weighed in. This case is the case for this Court to adopt the doctrine.

Numerous courts have applied the doctrine to protect an insured innocent of wrongdoing despite the wrongdoing of other insureds. See, e.g., *Vasques v. Mercury Casualty Co.,* 947 So.2d 1265, 1268 (Fla. Dist. Ct. App. 2007); *Watson v.*

United Servs. Auto. Ass'n, 566 N.W.2d 683, 691 (Minn. 1997); *Fittje v. Calhoun County Mut. County Fire Ins. Co.,* 195 Ill.App.3d 340, 552 N.E.2d 353 (1990); *Evanston Ins. Co. v. Agape Senior Primary Care, Inc.,* 636 Fed.Appx. 87 (4th Cir. 2016). *Cf. Home Ins. Co. v. Dunn,* 963 F.2d 1023 (7th Cir. 1992); *Ehrgood v. Coregis Ins. Co.,* 59 F. Supp. 2d 438 (M.D. Pa. 1998); *Sunrise Properties, Inc. v. Bacon, Wilson, Ratner, Cohen, Salvage, Fialky & Fitzgerald, P.C.,* 425 Mass. 63, 68-69, 679 N.E.2d 540, 544 (1997) (holding the firm could not be innocent but declining to determine whether the innocent insured provision would provide coverage to the individual attorneys who might be personally liable).

In *Jensen v. Snellings,* 841 F.2d 600, 617-618 (5th Cir. 1988), the Court held, because there was no evidence that the firm had any prior notice of the potential for a claim to be made against it (in contrast to the particular attorney who committed the malpractice), the innocent insured exception applied and coverage existed for the firm. There, as here *(Tab 9, p. 9 (of 22), § 1.1.)*, the policy provided that claims arising from acts or omissions occurring before the policy period were subject to exclusion, but they were excluded only if the insured knew or should have known at the effective date of the policy both of the wrongful conduct and that it might be expected to be the basis of a claim. *Id.*

In *deBruyne v. Clay,* 1999 WL 782481, *5 (S.D.N.Y. 1999), the court held

the claim was covered because all the partners swore that they were unaware of the claimant's threats to sue. Here, Michael swore he did not know of David's Illegal Acts, and David swore his acts were unauthorized. *App. Tabs 4 and 5.*

In *Perl v. St. Paul Fire and Marine Ins. Co.,* 345 N.W.2d 209, 216 (Minn. 1984), though the court did not refer to the innocent insured doctrine, it held there was coverage for the firm but not for the individual attorney who caused the loss because "we see no reason why the law firm should not be free to acquire insurance, if it can, protecting itself from vicarious liability for the misconduct." *Id.*

An illustration is helpful to understand why the innocent-insured doctrine is needed to further Montana's public policy of providing insurance protection. Say attorney T steals client funds before being hired by a Firm. No one in the Firm knew or should have known about the prior theft. After T is hired, the Firm applies for malpractice insurance and represents that there is no reasonable basis to believe that any of its lawyers are subject to claims. The Firm received coverage for year 1. In year 2, the Firm renews coverage after making the same application. In year 3, attorney C in the Firm is sued for malpractice. In year 4, the Firm is able to renew coverage because it promptly disclosed the claim against attorney C. Later in year 4, claims are asserted against attorney T for the theft of client funds that

occurred before T joined the Firm. The insurer then rescinds all policies issued to the Firm in years 1, 2, 3, and 4 based on attorney T's theft before joining the firm on the grounds that the insurer would never have issued any of the policies if the insurer had known about T's misrepresentation. Attorney C also loses coverage. The innocent insured doctrine was designed to prevent this from happening.

Though Montana has not yet adopted the innocent insured doctrine, it should because that is in keeping with the modern trend, and it is consistent with Montana's strong public policy favoring insurance coverage. In the case in which Minnesota adopted the innocent-insured doctrine, that state's Supreme Court noted:

> Early case law from other jurisdictions tended to deny recovery to innocent insureds. Public policy, it was thought, should discourage arson and other crimes, remove opportunities for fraud and collusion against insurers, and avoid making wrongdoing profitable. [Citation omitted] Nevertheless, the modern trend of case law has been to allow the innocent insured to recover.

Hogs Unlimited v. Farm Bureau Mut. Ins. Co., 401 N.W.2d 381, 385 (Minn. 1987). The court held, "It seems to us, notwithstanding the potential for fraud and profit from wrongdoing, that innocent insureds should not suffer for the aberration of a coinsured, whether a spouse or business colleague. We think this is the better public policy. We think it would be unfair and harsh to extend vicarious liability into this context." *Id.,* at 386. Montana likewise recognizes the "public policy ...

of providing indemnification to innocent victims." *Wendell v. State Farm Mut. Auto. Ins. Co.,* 1999 MT 17, ¶20, 293 Mont. 140, 974 P.2d 623.

There are only two reported Montana decisions addressing innocent insureds. In *Woodhouse v. Farmers Union Mut. Ins. Co.,* 241 Mont. 69, 72, 785 P.2d 192, 194 (1990), this Court declined to apply the doctrine where the policy language "clearly and unequivocally" excluded coverage for the act of the insured. The Court applied the same rationale in *Tyler v. Fireman's Fund Ins. Co.,* 255 Mont. 174, 177, 841 P.2d 538, 540 (1992), where the policy clearly stated, "This entire policy shall be void if, whether before or after a loss, the insured has willfully concealed or misrepresented any material fact or circumstance concerning this insurance or the subject thereof, or the interest of the insured therein, or in case of any fraud or false swearing by the insured relating thereto." *Id.*

The distinction between those two cases and this one is that here there is no provision in the Policy allowing ALPS to void the entire Policy as to all insureds due to the concealment or misrepresentation by one insured. Indeed, the only provision addressing misrepresentation allows ALPS to cancel the Policy on 10-days' notice. *App, Tab 9, p. 6 (of 22), § 4.13.2.*

There simply is no voidance clause in ALPS' Policy such as was at issue in *Tyler*. ALPS could easily have included provisions to void, rescind, reform, or

cancel the contract retroactively. It just didn't. This Court cannot insert any such clause in the Policy. In the absence of any such specific language, the innocent insured doctrine should apply.

In refusing to apply the doctrine in this case, the district court found persuasive the reasoning of *Illinois State Bar Ass'n Mut. Ins. Co. v. Law Office of Tuzzolino and Terpinas,* 2015 IL 117096, 389 Ill. Dec. 575, 27 N.E.3d 67. The court there held the innocent insured doctrine does not apply, because "that doctrine is relevant to issues of policy exclusions and insurance coverage, but it is unsuited to the case at bar, which deals with rescission and contract formation." *Id.,* ¶32. There was a strong dissent in that case, based on a) the reasonable expectation that the innocent insured maintained professional liability insurance based on his history with the insurer and his lack of culpability in the misrepresentation, b) the fact that the firm was organized as a limited liability entity and c) public policy considerations. *Id.,* ¶47.

Though the court below did not find the dissent persuasive, this Court should. There are several reasons why.

First, another Illinois case is helpful in understanding cases where the doctrine applies and those where it doesn't. In *Wasik v. Allstate Ins. Co.,* 351 Ill.App.3d 260, 813 N.E.2d 1152 (2004), a fire destroyed Wasik's garage. He

made a claim under his homeowners insurance policy. Allstate denied coverage because Wasik's stepson intentionally started the fire. 813 N.E.2d at 1153. Wasik filed a complaint, alleging Allstate's denial of coverage was a breach of the insurance policy. *Id.*

Allstate asserted the fire was the intentional act of an insured and that the stepson made material misrepresentations regarding the circumstances of the loss. Each party moved for summary judgment. *Id.* The trial court granted Allstate's motion. *Id.*, at 1155.

On appeal, Wasik argued that, as an innocent insured, he was entitled to recover under the policy despite the alleged wrongdoing of his stepson. *Id.* The general policy declarations stated, in relevant part: "'We do not cover any loss or occurrence in which any insured person has concealed or misrepresented any material fact or circumstance.'" *Id.* There was also an exclusion for intentional or criminal acts. *Id.*

In making its determination as to whether the innocent insured doctrine was applicable, the *Wasik* court discussed the leading Illinois decisions applying that doctrine: *Economy Fire & Casualty Co. v. Warren,* 71 Ill. App.3d 625, 28 Ill. Dec. 194, 390 N.E.2d 361 (1979), *West Bend Mutual Insurance Co. v. Salemi*, 158 Ill. App.3d 241, 110 Ill. Dec. 608, 511 N.E.2d 785 (1987), and *State Farm Fire &*

Casualty Insurance Co. v. Miceli, 164 Ill. App.3d 874, 115 Ill. Dec. 832, 518 N.E.2d 357 (1987). *Wasik,* 813 N.E.2d at 1156-1157. After reviewing those cases, the court determined that, although the relevant policy provisions could be read as entirely prohibiting coverage for a loss caused by the act or failure to act of "any" insured, "they do not clearly state that the policy will be void or coverage will be excluded as to all insureds in the event of some improper behavior by 'any' insured." *Id.,* at 1157. The court reversed the summary judgment in Allstate's favor and granted Wasik's motion for summary judgment. *Id.,* at 1158.

Under that rationale, M&M and Michael should not be denied coverage unless the language of the Policy clearly states that coverage will be excluded as to all insureds because of the misrepresentation by another insured. This Court should determine there is no such provision in the Policy and, so, the common law innocent insured doctrine should apply.

Another reason this Court should adopt the rationale of the dissent in *Tuzzolino & Terpinas, supra,* is that here, as there, M&M was operating as a limited liability entity – a professional limited liability partnership. The only evidence in this case is that David did not have the authority from M&M to submit untruthful responses to ALPS on any of its renewal applications, and his wrongful conduct was outside the scope of his authority. As such, David's actions may not

be imputed to or bind M&M or Michael relative to their rights under the ALPS' policy. See §§ 35-10-301 and 35-10-305, MCA; *First American Title Ins. Co. v. Lawson,* 177 N.J. 125, 142, 827 A.2d 230, 240 (2003) ("by organizing the firm as a limited liability partnership, Snyder had every reason to expect that his exposure to liability would be circumscribed in accordance with the Uniform Partnership Law. Stated differently, voiding Snyder's coverage solely because of his partners' wrongful conduct potentially would expose Snyder to uninsured liability in a manner inconsistent with his expectations under the UPL.")

Yet another reason to agree with the dissent in *Tuzzolino & Terpinas, supra,* is that similar policy considerations exist here. As the dissent aptly noted:

> In addition, I am troubled by the scope of the consequences resulting from the majority's holding on other law firms and especially midsize and large firms. Under the majority's view, a material misrepresentation on an insurance application could cause rescission of the policy as to each and every attorney, despite their reasonable expectations of continued professional liability insurance coverage. Furthermore, as the size of the affected firm increases, so does the potential harm to the public.

Tuzzolino & Terpinas, ¶54. It is difficult, if not impossible, to argue with that observation. Does every multi-lawyer firm in this State want to run the risk of having its malpractice policy voided based on an inaccurate answer by even a newly-hired associate? How is the policy of protecting innocent victims advanced by such a rule?

Public policy dictates the application of the innocent insured doctrine. In *Lawson, supra,* the court held:

> Moreover, voiding the policy in respect of Snyder would mean that he no longer would possess coverage for any of his actions in unrelated matters, including simple malpractice, that might have occurred during the period of anticipated coverage. Thus, applying the rule of law advocated by Underwriters could leave members of the public, whom Snyder had represented throughout that period, unprotected even though the insured himself committed no fraud. In our view, that harsh and sweeping result would be contrary to the public interest. More specifically, it would be inconsistent with the policies underlying our Rules of Court that seek to protect consumers of legal services by requiring attorneys to maintain adequate insurance in this setting.

Lawson, 177 N.J. at 143, 827 A.2d at 240. Though, as the district court observed, Montana does not have mandatory malpractice insurance, as the district court failed to observe, Montana does have the same strong public policy favoring insurance protection of innocent victims and here M&M and Michael reasonably expected to have insurance.

For these reasons, M&M and Michael ask this Court to reverse the judgment voiding the Policy as to them, and to determine as a matter of law that they are entitled to recover as innocent insureds. The case should be remanded for determination of the premium and trial of the counterclaims and third-party claims.

//

C. The rescission of the Policy in its entirety is not equitable because it did not restore the parties to the position they were in and it violates the reasonable expectations doctrine.

An insurer may not rescind a policy subsequent to a claim or loss unless it meets the requirements in both Mont. Code. Ann. Title 28 and Title 33. *Lentz v. Prudential Ins. Co.,* 164 Mont. 197, 204, 520 P.2d 769, 772 (1974).

The court determined ALPS met the requirements of § 28-2-1713, MCA by: a) rescinding promptly upon discovering the facts, and b) tendering back to M&M the full premium paid. Thus, the court found ALPS had met the requirements of Title 28 for rescission. *App., Tab 3, pp. 24-25.*

Other legal and equitable requirements warrant reversal of that decision as to M&M and Michael.

Section 28-2-1716, MCA, states: "On adjudging the rescission of a contract, the court may require the party to whom such relief is granted to make any compensation or restoration to the other which justice may require." This Court has explained the purpose of that statute:

> 'In this connection the question suggests itself as to what is the object of the requirement of restoration. Theoretically, it is to place the parties in statu quo. In this aspect, 'statu quo means to place such party in the same position as he was situated in at the time of the execution of the contract, but absolute and literal restoration of the parties to their former position is not required, and *such restoration as is reasonably possible and demanded by the equities of the case is sufficient*.' [Citation omitted; emphasis added] The rule . . . is

> founded obviously on the principle that he who seeks equity must do equity. Conversely, wherever under the circumstances of the particular case restitution by plaintiff is not essential to the complete administration of justice between the parties, it will not be required . . . The rule in regard to the matter is equitable, not technical.' [Citation omitted] 'An absolute and literal restoration of the parties to their former condition is not required; it is sufficient if such restoration be made as is reasonably possible and such as the merits of the case demand.' [Citation omitted]

Scott v. Hjelm, 188 Mont. 375, 380, 613 P.2d 1385, 1387 (1980), quoting: *O'Keefe v. Routledge,* 110 Mont. 138, 103 P.2d 307 (1940). The restoration rule is well-established in Montana. *See, e.g., Hollingsworth v. Ruckman,* 72 Mont. 147, 232 P. 180, 182 (1924).

Tendering back the premium was not sufficient to restore the insureds or the clients to the positions they were in on January 1, 2014. As of that date, when it was applying for renewal, M&M and Michael had been insureds of ALPS for eleven years. They never practiced law "bare." The object was to protect their clients from the consequences of any professional error. See, *e.g., Giacomelli,* 2009 MT 418, ¶31 ("the object of the insurance contract, ... is to give protection"); *Livengood, supra* ("'Montana's strong public policy [is] that insurance is to serve a fundamental protective purpose;...'") As of January 1, 2014, M&M and Michael reasonably expected they were protecting their clients by renewing that long-standing coverage.

More "was reasonably possible" than just voiding the Policy. The court

could have: rescinded only as to David, rescinded only as to coverage for David's Illegal Acts, reformed the Policy by increasing the premium for any actual increased risk, or provided M&M and Michael with coverage as innocent-insureds. Any of those alternatives would have served the dual purposes of the reasonable expectations doctrine and Montana's policy to protect innocent claimants. Voiding the policy left M&M and Michael without any insurance and innocent clients unprotected – with no ability on the part of Michael or M&M to obtain any coverage during the period at issue. Absent their ability to obtain substitute coverage, they were not put back into their original position. This is why the attorneys asked the Court to carve out coverage for M&M and Michael.

Generally, rescission is a harsh remedy and not favored. See, *e.g., Security Life Ins. Co. of America v. Meyling,* 146 F.3d 1184, 1192 (9th Cir. 1998) ("In other words, having elected to contract for a mandatory self-adjusting remedy which provides full compensation, Security cannot avail itself of the harsh common law remedy of rescission.")

In this case, rescission is too harsh because, if ALPS had cancelled the Policy, the cancellation would only have been effective prospectively.

§ 33-15-1103(1), MCA prohibits mid-term cancellation except for the following relevant reasons:

(c) on grounds stated in the policy which pertain to the following:

(i) material misrepresentation;

(ii) substantial change in the risk assumed, except to the extent that the insurer should reasonably have foreseen the change or contemplated the risk when the contract was written;

(iii) substantial breaches of contractual duties, conditions, or warranties;...

Id. Cancellation under "is not effective until 10 days after a notice of cancellation is either delivered or mailed to the insured." §33-15-1103(2), MCA.

Section 4.13.2 of the Policy *(App., Tab 9, p. 6 (of 22)* tracks §33-15-1103(1), MCA. Under Section 4.20, Montana law overrides the contract terms. *Tab 9, p. 7 (of 22).* The Policy mentions "rescission" only in connection with the issuance of an ERE under Section 4.4. *Id., p. 18 (of 22), ¶ 4.4.5(b).*[4] That Section is inconsistent with Section 4.13, which does not mention rescission or retroactive cancellation. Though an ERE may not be available, under the reasonable expectations doctrine, this Court should construe Section 4.13.2 in favor of coverage and against rescission or retroactive cancellation.

The Policy itself provides the exclusive remedy for misrepresentation and it

[4] "No [ERE] under this section, nor any continuation thereof, shall be available to the Named Insured, and if issued shall be deemed automatically canceled, where: (b) The Company cancels or rescinds this Policy or any other policy for misrepresentation in any application or other submission to the Company;..."

is not rescission. Had ALPS insisted on the ability to rescind as to innocent insureds, M&M could have asked for a severability provision to protect innocent insureds. If ALPS refused, then M&M could have obtained a policy from another insurer that contained a severability provision. Because the Policy does not provide for rescission at all, there was no reason for M&M or Michael to protect themselves from the kind of scenario at issue here.

Further, ALPS had options, as did the court below. ALPS never did exercise its right to the ten-day cancellation for misrepresentation. ALPS could have just as easily refused to cover David's Illegal Acts or rescinded as to David only. Under those scenarios, ALPS could have protected itself, the reasonable expectations of innocent insureds and victims would have been protected, and absolute rescission would have been unnecessary and unwarranted.

Given the fact that ALPS, a sophisticated provider of legal malpractice insurance, did not avail itself of the right it had to prospectively cancel the Policy but instead attempted to exercise a right to rescission, if rescission is allowed, ALPS must comply with the law. Public policy, complete justice, equity, and the reasonable expectations doctrine dictate that innocent clients with legitimate malpractice claims should be protected. In order for those objectives to be met, the Policy should not be rescinded as to those claims.

Thus, the judgment should be reversed as to coverage for M&M and Michael, and the case remanded for consideration of less harsh remedies and more complete restoration of the parties, and for trial of the counterclaims and third-party claims.

D. ALPS did not meet its burden to prove undisputed evidence of any of the elements under Section 33-15-403 as to M&M or Michael.

The district court held ALPS properly rescinded the Policy for material misrepresentation pursuant to § 33-15-403(2)(b), MCA. *App., Tab 3, pp. 27-28.*

Section 33-15-403(2), MCA, provides:

> (2) Misrepresentations, omissions, concealment of facts, and incorrect statements shall not prevent a recovery under the policy or contract unless either:
>
> > (a) fraudulent;
> >
> > (b) material either to the acceptance of the risk or to the hazard assumed by the insurer; or
> >
> > (c) the insurer in good faith would either not have issued the policy or contract or would not have issued a policy or contract in as large an amount or at the same premium or rate or would not have provided coverage with respect to the hazard resulting in the loss if the true facts had been made known to the insurer as required either by the application for the policy or contract or otherwise.

"This statute should be read in the disjunctive." *Schneider,* 247 Mont. at 338, 806 P.2d at 1035.

The district court did not make any findings under Sections 33-15-403(2)(a) or (2)(c). *App., Tab 3, pp. 27-28.* Because review here is *de novo*, this Brief addresses all three factors.

(1) Materiality.

ALPS did not carry its burden of proving undisputed evidence under Section 33-15-403(2)(b).

"The materiality of an insured's misrepresentation is determined by the extent the false answer 'initially influenced the insurer to assume the risk of coverage.... [T]he misrepresentation in the insurance application may be material if it diminishes the insurer's opportunity to determine or estimate its risk." *Schneider,* 247 Mont. at 339, 806 P.2d at 1035-1036. Thus, the materiality of a misrepresentation generally is measured at the time the insurer issues the policy rather than at the time of a claim or loss. *Id.* "The question of materiality is a question of fact." *Id.*

The court found David's answers were material. It held: "David McLean's answer deprived ALPS of its opportunity to determine whether the facts relating to David McLean's conduct created additional risk – even with the exclusions – because ALPS never had the opportunity to understand the nature of the facts that could give rise to the claim." *App., Tab 3, pp. 27-28.* The court relied heavily on

the Affidavit of ALPS' underwriter, Erika Taylor, that "ALPS would not have issued the Policy to M&M and its attorneys had the true facts been known regarding David McLean's misappropriation of funds." *(Doc. 35, pp. 2-3, ¶12)*.

This Court has held that if an issue is material to the insurer's acceptance of the risk, a prudent insurer expressly asks questions about the issue. See *Schneider,* 247 Mont. at 339, 806 P.2d at 1036.

ALPS' application failed to expressly ask M&M or Michael about the misuse or misappropriation of funds by anybody. Other than practice-related questions, it asked M&M about: 1) prior claims or suits; 2) awareness of "any fact, circumstance, act, error, or omission that could reasonably be expected to be the basis of a claim"; 3) any disciplinary complaints; 4) any change in status of a prior disciplinary complaint; 5) refusal of admission, disbarment, or suspension from practice, or any formal reprimands; and 6) "Is any attorney in your firm currently under investigation, charged with or been convicted of a felony or misdemeanor in the last three (3) years?" *App., Tab 10, p. 3 (of 9).* Other than practice-related questions, ALPS asked Michael individually about awareness of "any fact, circumstance, act, error, or omission that could reasonably be expected to be the basis of a claim." *Id., pp. 5-6 (of 9).*

If misappropriation of client funds or facts that might give rise to criminal

investigation or charges were material to ALPS' acceptance of the risk, under the prudent insurer rule, it was required to ask M&M and Michael about those things. *Schneider, supra.* It just didn't. ALPS did not ask, for example: "Are you or any member of the firm aware of or do you or any member of your firm have knowledge of any fact, circumstance, act, error, or omission that could reasonably be expected to lead to investigation, charges or conviction of a felony or misdemeanor?" It did not ask: "Are you or any member of the firm aware of or do you or any member of your firm have knowledge of any fact, circumstance, act, error, or omission relating to the misappropriation of funds?"

Both ALPS and the court reached the conclusion that M&M and Michael should have disclosed David's Illegal Acts in answering the questions about awareness of "any fact, circumstance, act, error, or omission that could reasonably be expected to be the basis of a claim." However, that is not a valid conclusion under the reasonable expectations doctrine.

The Policy made the applications a part of the Policy. *App., Tab 9, Declarations & p. 21 (of 22), § 4.14.1.* Thus, just as it approaches interpretation of the Policy itself, this Court must construe the applications based upon the objectively reasonable expectations of the insureds.

M&M and Michael contended the "No" answers to the questions about

awareness of "any fact, circumstance, act, error, or omission that could reasonably be expected to be the basis of a claim" were not false or material, not intended to be acted upon, and never acted upon in reliance by ALPS or caused damage to ALPS because they did not reasonably expect the Policy to cover David's Illegal Acts and the Policy does not cover them.

Specifically, David's Illegal Acts were not "an act, error or omission in Professional Services that were or should have been rendered by the Insured." *App., Tab 9, p. 9 (of 22), § 1.1.* David did not steal money on behalf of a client. Theft did not require David to apply his professional skills as an attorney – indeed it was the opposite of everything we are supposed to do. Further, the Policy contained several provisions excluding coverage for David's Illegal Acts. *Id., pp. 15-16 (of 22), §§ 3.1.1, 3.1.3, 3.1.8, and 3.1.9.*

When M&M and Michael submitted the application indicating they had no knowledge of any facts that could reasonably be expected to be the basis of a claim, that was true. Michael had no idea David had stolen money. M&M had not authorized David to steal money or provide false answers to ALPS. David was the sole bad actor. Further, Michael and M&M could not have objectively expected there would be coverage for David's thefts. Thus, M&M and Michael could not have been reasonably expected to have disclosed those Acts in response to the

questions ALPS asked.

Thus, ALPS failed to prove materiality under Section 33-15-403(2)(b), and the court's summary judgment should be reversed as to M&M and Michael. The case should be remanded for trial of all claims.

(2) Fraud.

ALPS did not carry its burden of proving undisputed evidence that M&M or Michael fraudulently completed the application under Section 33-15-403(2)(a).

"A party asserting a claim of actual fraud must establish the following elements: (1) a representation; (2) falsity of the representation; (3) materiality of the representation; (4) speaker's knowledge of the falsity of the representation or ignorance of its truth; (5) speaker's intent that it be relied upon; (6) the hearer's ignorance of the falsity of the representation; (7) the hearer's reliance on the representation; (8) the hearer's right to rely on the representation; and (9) the hearer's consequent and proximate injury caused by the reliance on the representation." *Morrow v. Bank of America, N.A.*, 2014 MT 117, ¶57, 375 Mont. 38, 324 P.3d 1167. The elements of actual fraud "hinge on the knowledge and intent of the defendant." *McCulley v. U.S. Bank of Montana,* 2015 MT 100, ¶34, 378 Mont. 462, 347 P.3d 247. The issue of fraudulent intent should "be determined in the light of all the surrounding circumstances and [is] a question of

fact to be determined at the trial." *Bails v. Gar,* 171 Mont. 342, 350, 558 P.2d 458, 463 (1976). Once a *prima facie* case is established, "[a]ctual fraud is always a question of fact." *Morrow, supra.*

As discussed above, ALPS failed to prove materiality. In addition to missing intent, without materiality, there was no fraud. Further, Michael's answers were true. For these reasons, summary judgment cannot be entered in favor of ALPS under § 33-15-403(2)(a).

(3) What ALPS would have done in good faith.

ALPS did not carry its burden of proving undisputed evidence under Section 33-15-403(2)(c).

Here, the prudent insurer rule should again apply. If misappropriation of funds was material to ALPS in issuing the policy or setting the coverage amount or premium, under the prudent insurer rule, it should have asked M&M and Michael about misappropriation of funds. *Schneider, supra.* ALPS presented no evidence that such considerations were in any underwriter's manual, not did it even put the manual in evidence. *Id.*

Based on the language of the Policy and the reasonable expectations doctrine, ALPS never would have covered misappropriation of funds, did not provide coverage for misappropriation, did not assume any such risk, and did not

assess any such risk in setting the coverage amount or premium.

Because the facts are in dispute as to whether misappropriation of client funds was a factor in terms of ALPS' conduct, summary judgment cannot be entered in favor of ALPS under § 33-15-403(2)(c) as to M&M and Michael.

7. Conclusion

The district court's judgment should be reversed as to M&M and Michael and the case remanded for trial on all remaining claims.

Dated this 17th day of March, 2017.

Strauch Law Firm, PLLC

By: /s/ Timothy B. Strauch
Timothy B. Strauch

Attorney for McLean & McLean, PLLP

-and-

Wall, McLean & Gallagher, PLLC

By: /s/ Patrick T. Gallagher
Patrick T. Gallagher

Attorney for Michael McLean

Certificate of Compliance

I certify that this brief is printed with a proportionately spaced Times New Roman text typeface of 14 points; is double-spaced (except that footnotes and quoted and indented material are single-spaced); with left, right, top and bottom margins of 1 inch; and that the word count calculated by Corel WordPerfect X5 is **9,703** words, excluding the Table of Contents, Table of Authorities, Certificate of Compliance, and Certificate of Service.

Dated this 17th day of March 2017.

Strauch Law Firm, PLLC

By: /s/ Timothy B. Strauch
Timothy B. Strauch

CERTIFICATE OF SERVICE

I hereby certify that on this 17th day of March 2017, I served a copy of the foregoing document in the above matter by e-mailing a copy thereof to:

Patrick T. Gallagher
Wall, McLean & Gallagher, PLLC
P.O. Box 1413
Anaconda, MT 59711
pat@mlfpllc.com

Martha Sheehy
Sheehy Law Firm
P.O. Box 584
Billings, MT 59103
msheehy@sheehylawfirm.com

Stefan Wall
Wall, McLean & Gallagher, PLLC
P.O. Box 1713
Helena, MT 59624
stefan@mlfpllc.com

Bradley J. Luck
Garlington, Lohn & Robinson, PLLP
P.O. Box 7909
Missoula, MT 59807-7909
bjluck@garlington.com

Doug Scotti
Sharon M. Morrison
Morrison & Frampton, PLLP
Frank Lloyd Wright Building
341 Central Avenue
Whitefish, MT 5993 7
doug@morrisonframpton.com
smmmontana@gmail.com

Janice M. Casarotto
Casarotto Law Firm, PLLC
P.O. Box 3723
Butte, MT 59702
casarottolawfirm@gmail.com

William M. O'Leary
Fleming & O'Leary, PLLP
P.O. Box 527
Butte, MT 59703
wmo@flemingandolearlylaw.com

/s/ Timothy B. Strauch
Timothy B. Strauch

CERTIFICATE OF SERVICE

I, Timothy B. Strauch, hereby certify that I have served true and accurate copies of the foregoing Brief - Appellant's Opening to the following on 03-17-2017:

Stefan T. Wall (Attorney)
P.O. Box 1713
Helena MT 59624
Representing: David M. McLean
Service Method: eService

Patrick T. Gallagher (Attorney)
P.O. Box 1413
Anaconda MT 59711
Representing: Michael David McLean
Service Method: eService

Douglas Scotti (Attorney)
341 Central Ave.
Whitefish MT 59937-2618
Representing: Miantae McConnell
Service Method: Conventional

Sharon M. Morrison (Attorney)
341 Central Ave.
Whitefish MT 59937-2618
Representing: Miantae McConnell
Service Method: Conventional

Martha Sheehy (Attorney)
P.O. Box 584
Billings MT 59103-0584
Representing: ALPS Property & Casualty Insurance Company
Service Method: Conventional

Bradley J. Luck (Attorney)
350 Ryman St.
P.O. Box 7909
Missoula MT 59807
Representing: ALPS Property & Casualty Insurance Company
Service Method: Conventional

William Michael O'Leary (Attorney)
510 E. Park Street, Suite 200
P.O. Box 527
Butte MT 59703
Representing: Joseph Micheletti, Marilyn C. Micheletti
Service Method: Conventional

Janice M. Casarotto (Attorney)
P.O. Box 3723
Butte MT 59702
Representing: Lillian Johnson
Service Method: Conventional

Electronically Signed By: Timothy B. Strauch
Dated: 03-17-2017